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AgExporter

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China, Hong Kong and Taiwan

How U.S. Trade Relationships
With Three Major Markets
Could Change in the Wake
of WTO Accessions,
Trade Liberalization and
Shifting Trade Flows

AgExporter

United States Department of Agriculture
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March 2002

Features



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As China becomes more integrated into the international community, impetus for change is coming from diverse sources: more liberal trade policies and practices; more foreign investment; and a more market-oriented economy with more consumer choice.

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France's Little Animal Kingdom

By Laurent Journo and Kurt Seifarth

With favorite dogs bundled lovingly into shoulder bags for riding on the Métro or curled up under tables at its famous sidewalk cafés, Paris is paradise for pets—and France is one of Europe's best markets for pet food products. The “myth” of tiny dogs nestled in shopping bags at Le Bon Marché or under chairs at Paris's five-star restaurants is not a myth at all.

In fact, France has the largest pet population in Europe, with 10.2 million dogs, 8.5 million cats, 7 million birds, 2 million rodents and a remarkable 27 million fish. The French are simply animal lovers, with 53 percent of households having at least one pet.

Going to the Dogs? Far From It!

The \$2.8-billion pet food market is a testament to the special feeling the French have for their pets. About 53 percent of that total goes for dog food, and roughly 38 percent goes for cat food. For the last three years, overall pet food sales have grown at a healthy 3 percent a year.

French consumers' number of shopping trips for their pets and their average expenditures have increased markedly, too. In 2000, the dog food market grew 3.5 percent from the year before, and the cat food market 3 percent. Dog owners spent an average \$120, and cat owners an average \$86, on their animal companions. But the rodent pet food segment grew the fastest, surging 9 percent.

Supermarket chains dominate French pet food distribution, accounting for 78



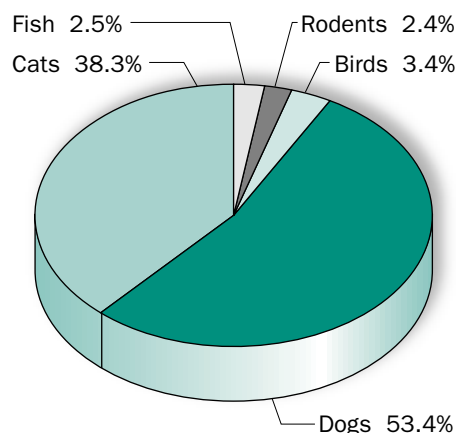
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percent of all sales. Sales of products going through the specialized distribution network (pet shops, garden centers and specialty supermarkets) make up another 14 percent. The rest of the market is shared

among veterinarians, groomers and seed merchants. But the greatest proportion of high-value and import product sales come from veterinary clinics, grooming salons, garden centers and traditional pet shops.

Garden centers are proving to be France's most dynamic distribution network for pet food, with sales growth of 10 percent in 2000. By comparison, traditional pet shops posted only 4 percent growth in that year's firm sales recovery.

Sales Vary by Type of Animal



The Competitive Pack

Overall, France has been and should be a great market for U.S. pet food. But some dramatic factors have constrained sales in recent years, such as the strong U.S. dollar making U.S. products comparatively expensive, and European Union (EU) restrictions on imports of meat and bone meal (a main ingredient in many pet food products) aris-

Insights From an Insider

Now for some valuable perspective on the market, here's an interview with Louis Gauthier, President of Iams France.

What is Iams' position in the French market?

Louis Gauthier: Iams is still underdeveloped in the French market, although the company is a leader in North America's specialty market. France is a key target for Iams.

What type of products do you sell?

LG: People are increasingly careful about the health of their pets, and the pet food market has followed this trend. Iams considers itself a pet nutrition company rather than a pet food company, focusing on high-quality food products. Iams is a pioneer in France's specialty segment.

What are the best products in sales-dry or wet?

LG: Iams produces mostly dry food, because premium nutritional ingredients can

be better concentrated in dry items. Although wet products are commercially important, wet product sales have been constantly declining in recent years.

Is there a market for U.S. pet food in France?

LG: Absolutely, there's a place for U.S. products, if they are of high quality. Iams is not the only pet food company in France: Hill's, Purina and Mars have opened offices, too.

Do the French care about the origin of a product?

LG: They would rather choose French products; that partly explains the position of Royal Canin as the specialty segment leader. But Mars, an American firm, is important in the grocery supermarket segment, where 80 percent of sales occur.

Where do you produce pet food for the French market?

LG: We have one plant in the Netherlands, which produces over 90 percent of the products we sell in France, and products for the rest of Europe. Less than 10 percent of

French sales are imports, and only two products are produced in the United States.

Have you had any problems with French customs?

LG: In 1997, when BSE started to be a big issue, customs stopped our imports for nine months.

How did you resolve it?

LG: We had to adhere very strictly to French requirements and get our products certified. We also constructed the Netherlands plant and reduced imports from outside the EU.

What are your next objectives?

LG: Selling our products to veterinarians, stock breeders, etc.; they then recommend and sell our products to their clients. Our main distribution network is a group of specialized outlets. The next step is to corner the premium market share, and we will expand Iams dog and cat product sales in the grocery channel, while remaining focused on the specialty channel.

ing from concerns about bovine spongiform encephalopathy (BSE).

Moreover, pet food manufacturing is big business, and the giants keep buying up competitors and moving their production sites. France itself is a pet food producer, manufacturing 2 million tons in 2000, some of it under U.S. brand names.

A strong merging movement is taking shape here: Masterfoods, which currently has a 40.7-percent market share, has recently acquired Royal Canin (with a 3.5-percent share). Nestlé recently received the green light from the EU government in Brussels to purchase the number-one U.S. pet food company, Ralston Purina. Meanwhile, Procter and Gamble is working to establish its brand name products, Eukanuba and Iams.

Tips for an Easier Entré

The hottest products in the French pet food market are high-value foods and snacks. Gourmet and specialized diet items and premium foods are increasingly in demand. Natural, healthy and organic preparations are also drawing attention.

The FAS Office of Agricultural Affairs in Paris stands ready to help U.S. pet food suppliers and exporters gain a foothold in France's lucrative but highly competitive market.

Trade shows and trade missions provide a cost-effective way to explore the market. In May 2002, for example, the FAS Paris office is conducting a trade mission with the American Pet Products Manufacturers Association to test the market and to make crucial trade contacts.

Major pet product shows in Europe include:

Interzoo:	May 9-12, 2002, Nuremberg, Germany, www.interzoo.com
Expozoo:	March 23-25, 2003, Paris, France, www.expo.zoo
Zoomark International:	April 11-14, 2003, Bologna, Italy, www.zoomark.it
Sizoo:	Oct. 16-19, 2003, Barcelona, Spain, www.sizoo.com ■

The authors are the agricultural marketing assistant and the attaché with the Office of Agricultural Affairs, Paris, France. For more information about the French market for pet food or assistance in exporting these products to France, contact that office at: Tél.: (011-33-1): 4312-2277; Fax: (011-33-1) 4312-2662; E-mail: agparis@fas.usda.gov

Fact File

Upturn Continues as U.S. Exports Score Another Gain

by Ernest Carter

Despite a year of mounting challenges, the upturn continued. U.S. agricultural exports emerged with another gain, rising \$2 billion or 4% to nearly \$53 billion in fiscal 2001.

This was the second annual increase following three progressively weaker years during which exports retreated to \$49 billion, down from a record-high \$60 billion in 1996. Trade forecasts suggest that 2002 will add a third year of growth to the current rebound.

U.S. agricultural exports first surged past \$50 billion in 1995, during a short-lived spike in prices and reduced competition in bulk commodity trade. Despite the weaker outlook for global economic growth since the mid-1990s, U.S. exports again topped \$50 billion in 2000 and 2001. Prior to 1995, exports had never been higher than \$44 billion.

Last year's performance was achieved with new records in exports to both of our NAFTA partners, along with strong sales to China, Indonesia and Russia. Exports of cattle hides and soybeans reached record

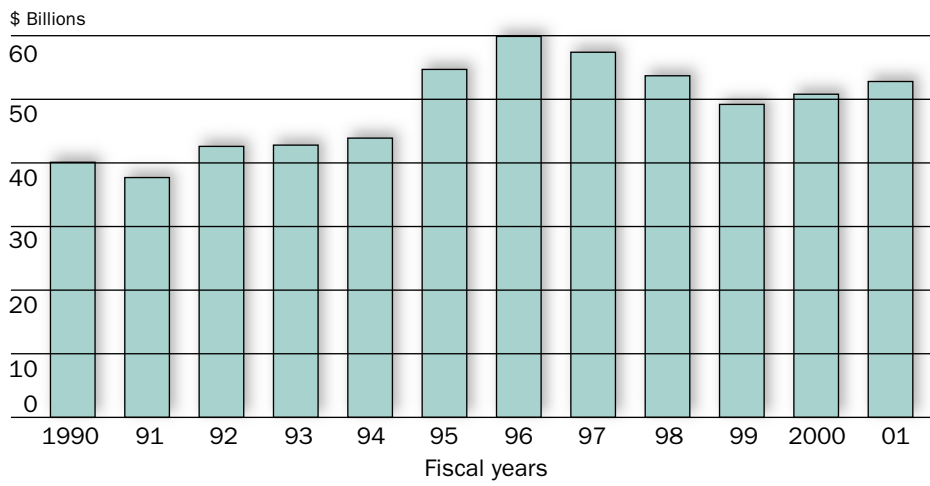
highs, as did the broad category of consumer foods. Trade gains were held in check by weak Japanese demand, a slowing world economy and the strength of the dollar.

In the forestry and fishery areas, fiscal 2001 results were mixed. U.S. exports of solid wood products dropped 13% to \$5.4 billion, while seafood exports increased 9% to \$3.0 billion. Altogether, U.S. agricultural,

forestry and fishery exports totaled \$61.2 billion in 2001, up 2% from 2000.

Imports remained largely unchanged, as \$39.0 billion in foods, beverages and other agricultural products entered the country. With higher exports and basically steady imports, the U.S. agricultural trade surplus for fiscal 2001 climbed to \$13.8 billion, a nearly \$2-billion gain from 2000.

U.S. Agricultural Exports Reached \$53 Billion in 2001, Up \$2 Billion From Previous Year



Bulk Agricultural Exports Remain Flat

U.S. bulk commodity exports were stymied by large global supplies and a strong dollar. Bulk export volume dropped 3% from the previous year to 112 million metric tons, mainly reflecting reduced grain shipments. Export value remained largely unchanged, as it has since 1999. U.S. corn battled stiff competition from China and Argentina. Soybeans set another volume record at 26.6 million tons, with nearly \$1 billion in sales to China, but abundant supplies put a lid on prices. Sharply lower exports to Egypt trimmed total U.S. wheat sales by 4% to \$3.3 billion. Cotton was up 14%, reflecting a larger U.S. crop, less competition from China and record sales to Mexico and India. Rice exports were off 14% because of stagnant demand and increased competition from Vietnam and Thailand.

	FY 2000	FY 2001	Change
Commodity	—\$ million—		Percent
Coarse grains	5,283	5,230	-1
Soybeans	5,072	5,106	+1
Wheat	3,398	3,256	-4
Cotton	1,829	2,094	+14
Tobacco	1,227	1,181	-4
Rice	909	782	-14
Pulses	240	251	+5
Peanuts	237	135	-43
Other	378	424	+12
Total	18,573	18,458	-1

Note: Fiscal years are October-September (i.e., fiscal 2001 ran Oct. 1, 2000-Sept. 30, 2001.) All numbers are rounded from original data.

Exports of Intermediate Agricultural Products Set Growth Pace

U.S. exports of semi-processed and other intermediate products increased 9% to \$11.7 billion in fiscal 2001, outpacing the growth for consumer foods. Hides and skins were the big winner, with exports up 36% to a record \$1.9 billion. Hide sales to No. 1 market South Korea increased by a third to \$613 million, and exports to China more than doubled to \$378. U.S. cattle, hogs and other live animals also collared a new export record at \$827 million, with strong gains to Canada, Mexico, Europe, Japan and the United Arab Emirates. Planting seeds, vegetable oils, animal fats and wheat flour were down from the previous year. For intermediate products as a group, the U.S. export record stands at \$12.3 billion, set in 1997.

	FY 2000	FY 2001	Change
<i>Commodity</i>	—\$ million—		Percent
Hides & skins	1,413	*1,923	+36
Feeds & fodder	1,704	1,753	+3
Soybean meal	1,226	1,378	+12
Live animals	709	*827	+17
Sugar, sweeteners & beverage bases	689	749	+9
Planting seeds	777	731	-6
Veg. oils (excl. soy oil)	821	701	-15
Animal fats	409	310	-24
Soybean oil	278	240	-14
Wheat flour	130	104	-20
Other	2,555	*3,007	+18
Total	10,711	11,724	+9

*Denotes record-high export value.

Consumer Products Ring Up Another Record

U.S. exports of consumer products maintained their record-breaking ways last year, climbing 5% to \$22.6 billion. Mexico, Russia and Canada accounted for most of the growth. Among product groups, new sales highs were set for fresh and processed fruits and vegetables, snack foods, dairy products, pet foods and breakfast cereals. Although shy of the 1997 record, U.S. poultry exports increased 14% from the previous year to \$2.2 billion as sales to Russia more than doubled to \$586 million. Record red meat exports to Mexico were more than offset by declines to Japan, South Korea, Russia and other markets. Fruits, vegetables and other horticultural products put in a strong showing, with robust sales to Canada and Mexico. For the third year in a row, consumer products made up the largest category of U.S. agricultural exports, accounting for 43% of total export value in fiscal 2001, up from 24% in 1990.

	FY 2000	FY 2001	Change
<i>Commodity</i>	—\$ million—		Percent
Meat, poultry, dairy			
Red meats	*5,305	5,084	-4
Poultry meat	1,943	2,218	+14
Dairy products	999	*1,114	+12
Eggs & products	176	200	+14
Fruits & vegetables			
Fresh fruit	2,009	*2,158	+7
Proc. fruit/veg.	2,089	*2,156	+3
Fresh vegetables	1,221	*1,268	+4
Fruit/veg. juices	753	719	-5
Snack foods	1,497	*1,681	+12
Tree nuts	981	1,130	+15
Pet foods	767	*1,001	+31
Wine & beer	710	744	+5
Breakfast cereals & pancake mix	374	*409	+9
Nursery products & cut flowers	258	255	0
Other	2,433	*2,464	+1
Total	21,514	*22,600	+5

*Denotes record-high export value.

NAFTA Partners and China Give \$2-Billion Boost to U.S. Exports

Of last year's 10 leading U.S. agricultural export markets, three—Canada, Mexico and China—boosted our export sales by nearly \$2 billion. Both Canada and Mexico rang up record purchases. Together, our two NAFTA partners took an unprecedented \$15.3 billion in U.S. agricultural products, for the first time exceeding our sales to Japan and the European Union (EU) combined. As recently as 1995, exports to Japan and the EU were twice as large as exports to NAFTA. U.S. sales to recession-mired Japan fell again, but there was better news elsewhere in Asia. Sales to China rose to the highest level since 1995 on the strength of record U.S. exports of soybeans, hides and consumer foods. Exports to Indonesia were up 30%, boosted in part by record-high U.S. soybean meal shipments to that country.

	FY 2000	FY 2001	Change
<i>Market</i>	—\$ million—		Percent
Japan	9,304	8,953	-4
Canada	7,525	*8,011	+6
Mexico	6,317	*7,288	+15
European Union	6,206	6,267	+1
South Korea	2,532	2,552	+1
Taiwan	2,010	1,985	-1
China	1,466	1,884	+29
Hong Kong	1,249	1,253	0
Egypt	1,056	1,008	-5
Indonesia	675	879	+30
Rest of world	12,458	12,703	+2
Total	50,798	52,783	+4

Data include bulk, intermediate and consumer-oriented agricultural exports.

**Denotes record-high export value.*

Wood Product Exports Lose Ground

World markets offered more challenges than rewards for U.S. solid wood products in fiscal 2001. A strong U.S. dollar, the global economic slowdown, the weak Japanese housing market and competition from Eastern Europe and Russia all combined to slow U.S. sales. Exports slumped 13% to \$5.4 billion—the lowest in more than a decade and sharply below 1997's \$7.5-billion record. Following a four-year climb to \$1.8 billion in 2000, exports fell 6% to our No. 1 market, Canada. Sales to Japan weakened for the sixth straight year, sagging another 18% to \$1.2 billion. Exports to the EU, our No. 3 wood market, were off 16% to \$1.1 billion. Of our top 10 markets, only China posted a gain—up 40% to \$118 million—based on strong U.S. log and chip sales. Overall, hardwood lumber exports were off 13% from the previous year's record, and softwood dropped 27%.

	FY 2000	FY 2001	Change
<i>Commodity</i>	—\$ million—		Percent
Logs & chips	1,659	1,572	-5
Lumber			
Hardwood	*1,440	1,258	-13
Softwood/treated	780	572	-27
Panel products	1,034	915	-12
Other	*1,322	1,126	-15
Total	6,236	5,444	-13

**Denotes record-high export value.*

Seafood Sales Buoyed by Rising Demand, Larger Catch

U.S. fishery products swam on a rising tide for the third straight year in fiscal 2001, as exports topped \$3 billion for the first time since 1995. The 9% gain in value reflected record sales to the EU and South Korea, among others. U.S. exports to the EU were up 17% to \$522 million, as European demand for seafood was bolstered by worries over BSE and foot-and-mouth disease. Exports to Korea jumped 62% to \$311 million. Among product categories, Alaska pollock, fish roe and surimi registered the big gains, with roe—especially pollock roe to Japan and Korea—up 29% to a record \$547 million. A sharp increase in the allowable catch and reduced pollock supplies from Russia get the credit for larger Alaska pollock roe and fillet exports. The U.S. record for total seafood exports to all countries remains at \$3.3 billion, set in fiscal 1992.

	FY 2000	FY 2001	Change
<i>Commodity</i>	—\$ million—		Percent
Salmon			
Whole/eviscerated	346	305	-12
Canned	*201	151	-25
Roe & urchin (fish eggs)	423	*547	+29
Surimi (fish paste)	279	323	+16
Crab/crabmeat	115	94	-18
Other	1,417	1,600	+13
Total	2,781	3,019	+9

**Denotes record-high export value.*

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Taiwan Joins the WTO: Anticipated Opportunities for U.S. Food Exports

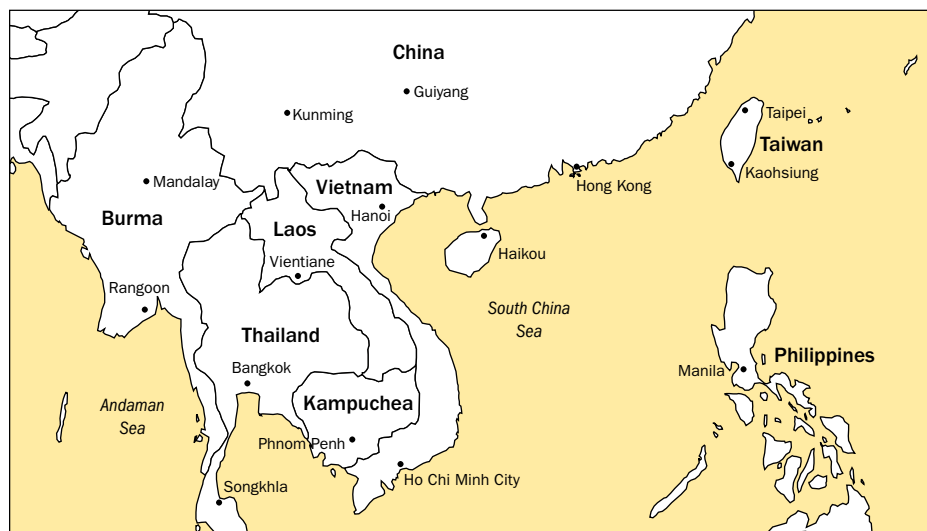
Taiwan officially entered the World Trade Organization (WTO) on Jan. 1, 2002, where it will be designated as Chinese Taipei. Taiwan's entry into the WTO's rules-based global trading system follows 12 years of intense negotiations with Australia, the European Union, New Zealand and the United States.

About 15-20 percent of the products sold in Taiwan's supermarkets and hypermarkets, as well as about 15 percent of the products sold in convenience stores, are imported. Imports are expected to increase because Taiwan agreed to reduce tariffs and open its markets to gain WTO membership. Under the U.S.-Taiwan bilateral market access agreement, Taiwan agreed to open its rice market for the first time and to increase access for pork, beef and poultry variety meats and chicken meat.

Demographics

Taiwan is 13,900 square miles in area. About two-thirds of the island is covered with lushly forested mountains. People on the west coast spend more on food than those living on the east coast, but the cities Taipei and Kaohsiung have the highest expenditures for food. The majority of all department stores, convenience stores, supermarkets and hypermarkets are located in the northern portion of the island.

The average age of convenience-store customers is around 20. More shelf space is now allocated to trendy and fashionable products, especially products in small and attractive packaging. This reflects the targeting of younger consumers.



Market Entry

Traditionally, buyers for Taiwan's supermarkets, hypermarkets and convenience stores purchase from local importers, wholesalers and manufacturers. However, the trend is toward direct imports to avoid the higher cost of products purchased from importers and local manufacturers. U.S. suppliers interested in expanding their business with these retail chains are encouraged to contact them directly. Buyers in Taiwan's retail stores tend to buy and import directly those products that are already well-known in the market.

A trend among supermarkets and hypermarkets is to begin importing directly from a consolidator that can arrange one large shipment containing a variety of new and/or already-in-the-market products.

A visit to Taiwan is an excellent way to start establishing meaningful relationships with potential buyers. U.S. suppliers are encouraged to bring product samples for potential buyers, as many importers and retailers rely heavily upon subjective factors when deciding on new products to represent.

U.S. companies wishing to promote their new-to-market or already-in-the-market products in retail stores are encouraged to contact store buyers directly. Taiwan's major

retail chains usually maintain teams of buyers specializing in product categories. However, it is recommended that you initially contact the team leaders and food directors or managers to introduce your company and products. After further contacts, these retail chains might purchase and import directly or through a designated importer.

- **Direct:** The best method to reach Taiwan's retail buyers is to initially contact them directly via e-mails or faxes. Product catalogues and price lists are essential. Sample products are helpful. U.S. suppliers can obtain a list of major Taiwan retail stores from the Agricultural Trade Office (ATO), Taipei.
- **Indirect:** U.S. companies may wish to concentrate on establishing their business relationships with a reliable and efficient importer and distributor, who in turn will sell the imports to these retail stores. The ATO Taipei maintains listings of potential importers for U.S. suppliers.
- **Online Purchasing:** Some retail chains, especially those with foreign joint venture partners such as Carrefour and RT Mart, currently purchase online a very limited group of product items.



TAIWAN'S ACCESSION IS EXPECTED TO LIBERALIZE FOOD IMPORTS.

Retail Service Trends

Taiwan's retail food chains will increase the number of products carried and services offered to attract more customers. Taiwan's individual food needs are changing, because many women are working outside the home and there are more single-person households. As a result, small packaged products and ready-to-cook dishes are becoming more popular. Retail stores are increasing the percentage of convenience foods, microwaveable foods, vegetarian foods and health foods in their offerings. To attract working women and individuals living alone, retail stores continue to extend their services, such as home delivery and businesses inside their stores—like bakeries, restaurants, dry-cleaners, photo studios and ready-to-eat food kiosks.

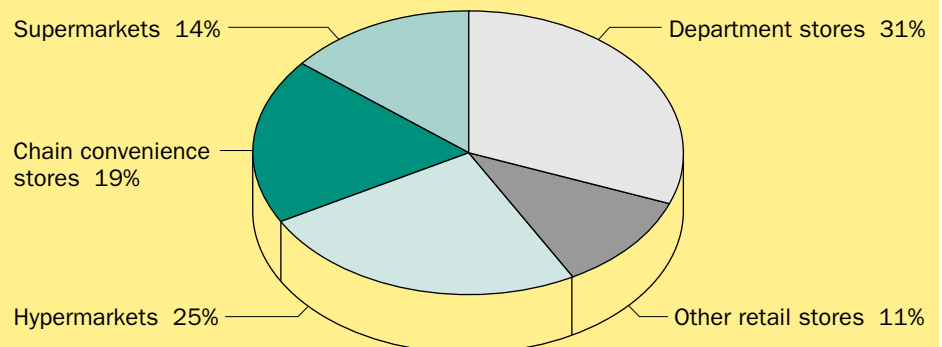
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Food Retailing in Taiwan

Although modern Western-style retail stores have been present in Taiwan for more than 20 years, there has been explosive growth in convenience stores, supermarkets and hypermarkets. Food retailing in Taiwan has entered a new era—one of strong competition, mergers and greater concentration.

According to statistics from Taiwan's Ministry of Economic Affairs, convenience stores, supermarkets and hypermarkets currently account for 57 percent, or \$11 billion, of Taiwan's total food sales. The market share of these modern food outlets is projected to continue to rise during the next few years.

Taiwan's Retail Outlet Market Share



Total Modern Retail Sales \$19 Billion

Last year, U.S. agricultural exports to Taiwan totaled more than \$2 billion. The Taiwan market ranked as the fifth largest for imports of U.S. agricultural products. Taiwan's WTO accession could add some \$500 million a year to U.S. sales. Now that Taiwan is in the WTO, U.S. high-quality beef, fresh fruits and vegetables, seafood, frozen prepared foods and other processed foods will face significantly lower import duties. However, Taiwan's WTO membership will also intensify competition among

the world's major food and agricultural exporters for a share of Taiwan's growing food import market.

Import tariffs for agricultural products will be reduced from a pre-accession average of 22.02 percent to 14.01 percent in the year following accession, and tariffs will be trimmed gradually to around 12 percent by the end of 2005. Tariffs on some 300 items of key interest to the United States were cut an average of 45 percent upon accession. ■

Weighing the Pros and Cons: U.S. Agricultural Trade in Taiwan

Advantages

- Taiwan's consumers perceive U.S. products to be of high quality.
- The majority of consumers can afford imported food products.
- Taiwan's WTO accession will provide U.S. exporters with more market opportunities.
- The growing, modern retail industry is looking for new imported food products.

Disadvantages

- Importers and retailers lack familiarity with U.S. brands.
- Consumers lack brand awareness.
- Competition among major world agricultural and food exporters for a share of Taiwan's growing market will further intensify after WTO accession.
- Importers and retailers lack knowledge and training in purchasing, handling and merchandising U.S. products.



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For more information or assistance in exporting to this market, contact the Agricultural Trade Office (ATO), American Institute in Taiwan, Taipei, Taiwan; Tel: (886-2) 2305-4883; Fax: (886-2) 2305-7073; E-mail: ato@mail.ait.org.tw, or ATOTaipei@fas.usda.gov

Taiwan's Imported Unprocessed Foods

- **Fresh fruits:** Direct import of fresh fruits by retail stores is expected to continue to increase during the next few years from the current 15 percent of Taiwan's total fresh fruit imports.
- **Fresh and frozen meats:** On average, the ratio of direct and indirect beef imports by Taiwan's hypermarkets is 40:60. Local importers provide beef imports to supermarkets, and both supermarkets and hypermarkets purchase pork from local importers.
- **Fresh and frozen seafood:** All but 2 percent of imported seafood is sold to retail stores through importers, wholesalers and distributors.
- **Private label:** Because the average selling price of private label products is 15-20 percent lower than for branded items, they are increasing in popularity. Many retail chains active in the Taiwan market, including 7-Eleven, Makro, Wellcome, Aimai-Geant, Costco and Tesco, are aggressively promoting private label products (both imported and domestic) to offer differentiation and increase markups.

For details, see FAS Reports TW1035, TW1048, TW1053 and TW2002.

To find them on the Web, start at www.fas.usda.gov, select **Attaché Reports** and follow the prompts.



What Change in China Means For Trade in Hong Kong

By George D. Ferris

For well over a century, Hong Kong has been regarded as the gateway to China. During its history as a British colony, it experienced enormous economic development because of its location on the doorstep of China, its flexibility in working with several cultures and the virtual absence of trade barriers. The huge differences in import access, plus Hong Kong's strategic location, made it an irresistible environment for goods to be transshipped to China.

Hong Kong's trade community has staunchly supported China's accession to the World Trade Organization (WTO), believing that it will lead to stronger economic growth. The Hong Kong government has also been a strong supporter, partly because it sees China's greater participation in the international trading community as further ensuring the continuation of Hong Kong's independence in the area of economic policymaking, and prosperous free-trade lifestyle. At the same time, the more progressive Hong Kong trading firms are considering what changes in their operations will enable them to remain an integral part of U.S.-China trade.

Many U.S. agricultural exports—mostly consumer-ready foods and commodities for further processing—make their way into China through Hong Kong. Its duty-free status and proximity to China have allowed Hong Kong to become the eighth-largest destination for U.S. agricultural exports, and fourth-largest for U.S. consumer-ready products.

In 2001, 47 percent of Hong Kong's



agricultural imports from the United States were re-exported to China. Many observers believe that in the next three or four years, China's import liberalization will result in the rechanneling of an increasing share of imports directly to Chinese destinations. But while Hong Kong's share of this trade will likely decline as China becomes further integrated into the WTO, the absolute volume of China's imports should climb.

Since it rejoined China on July 1, 1997, Hong Kong has maintained a high degree of autonomy under the "one country, two systems" provisions of the Basic Law governing the reunification. The legislation is designed to safeguard Hong Kong's social and economic systems, rights and freedoms for at least 50 years. The Hong Kong government exerts its own authority on economic and international trade issues, while following Beijing's principles on foreign relations and national security.

Hong Kong maintains separate representation to several international organizations, including the WTO, the World Customs Organization and the Asian Development Bank. Although they may consult Beijing, Hong Kong representatives have on occasion adopted positions that are independent from, and significantly more supportive of, international cooperation than those of their Beijing counterparts.

Hong Kong retains its own import system. Most re-exports from Hong Kong to China are handled by Hong Kong transport companies that provide freight forwarding services to Hong Kong importers, moving their goods into China, taking care of documents and paying tariffs. These companies' fees reflect shipping conditions at mainland ports, and they typically rise when the Chinese government institutes crackdown measures, such as more stringent sanitary standards. The periodic crackdowns contribute to uncertainty about depend-

able access to China, thereby inhibiting the trade environment.

Commodity Breakdown

What China's WTO accession will mean varies by commodity. Here are analyses of the forthcoming dynamics in major categories:

Fresh fruits: The extensive distribution infrastructure in China's Guangdong Province—the Nanhai Lishui market and the transportation network that feeds into it from all over southern China—will keep Hong Kong actively involved in China's fresh fruit imports for the foreseeable future. However, Hong Kong companies handling this trade may be forced to move to, or at least expand their presence in, China to take on competition from mainland companies attempting to take over the trading, shipping and financing roles long performed by Hong Kong firms.

Over the longer term, as its agricultural sector evolves to counter stronger import competition, China can be expected to increase production of labor-intensive

commodities, such as fresh produce, for which it has a competitive advantage. Because China is both a buyer and a growing competitor, U.S. suppliers must increase their emphasis on selling high-quality products in this market.

Tree Nuts: Infrastructural factors will likely keep a sizeable volume of China's tree nut imports coming through Hong Kong. For pistachios and to a lesser extent for almonds, Hong Kong trading companies have established cracking and slicing/roasting operations in Guangdong Province that rely on U.S. imports through Hong Kong. The processed products are distributed throughout China and also re-exported to Hong Kong.

Meats and Poultry: Almost 60 percent of U.S. frozen meat products going to China flow through Hong Kong, mostly in the form of poultry. Now that China has entered the WTO, reductions of duties and the easing of improper import restrictions will make Shanghai, Dalian, Tianjin and other mainland ports attractive entry



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points. For the foreseeable future, trade will continue through Hong Kong—but several major U.S. poultry firms are rapidly expanding distribution channels in China. A lot of the U.S. poultry exported to Hong Kong is handled by multi-national firms that are willing and able to relocate.

Financing will be slower to shift from Hong Kong companies because when sales slip, Chinese buyers simply may postpone paying for the goods ordered. Therefore, Hong Kong will continue to play a vital role in financing U.S. poultry meat shipments.

Cotton: China's WTO accession will probably have diverse impacts on Hong Kong's cotton trade. Garment manufacturers with plants in China expect to benefit from better access to the U.S. apparel market. Demand for locally produced yarn will climb, boosting cotton consumption. China's imports of U.S. cotton will also rise.

On the other hand, Hong Kong traders could lose business to Chinese importers. And while Hong Kong spinning mills may have more business, their profit margin is likely to drop. Chinese yarn producers will be able to import raw materials at lower tariffs, reduce production costs and offer their goods at lower prices.



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Fish and Seafood: High demand for fresh seafood will necessitate increased shipments via air freight. Hong Kong will therefore remain an integral part of this trade because it has many more daily international flights than most major Chinese cities.

Hardwoods: Virtually 100 percent of U.S. hardwood lumber imported into Hong Kong is re-exported to China for further processing. U.S. exports are expected to grow to meet China's housing, furniture, paneling and flooring needs. Hong Kong will continue as a significant gateway to the Chinese market because of its traders' expertise in managing large, high-value shipments, and because Hong Kong is the major deepwater port serving Guangdong Province.

Financing Considerations

Many other factors will also influence trade flows among the United States, Hong Kong and China. One major consideration is the extent to which U.S. exporters are willing to make new contacts in China and assume additional risk in the area of payments. Their Hong Kong partners will seek to convince them to continue doing business through existing channels; on the other hand, potential partners in China could offer innovative pricing and distribution plans that deserve serious consideration.

Hong Kong will likely continue in its current financial role for at least another five years, for several reasons:

- It remains difficult for private companies in China to obtain letters of credit.
- Although larger Chinese importers may be able to pay in U.S. dollars, the majority cannot. Moreover, Chinese currency is not fully convertible outside China.
- With Hong Kong companies, U.S. ex-

porters are reasonably assured of getting paid.

- Hong Kong has a Western-style legal system with the rule of law and enforceable contracts.

The Future of an Export Hub

Hong Kong continues to offer significant advantages as a trade entrepôt. As the world's largest container port, it can accommodate the very largest ships. Its size—and its location at the mouth of the Pearl River estuary—will keep Hong Kong involved in Southern China's trade, regardless of import policy changes.

Veteran Hong Kong traders estimate the share of China's agricultural imports coming through Hong Kong could drop to 30 percent. In years to come, 50-60 percent of U.S. shipments will go directly to Shanghai in Southern China, and 10-15 percent will go to Dalian in Northern China. However, China's total import volume will likely expand so much that Hong Kong's absolute volume of re-exports to China could remain near the current high levels for many years.

With the same ethnic makeup as its huge neighbor, a healthy average disposable income (\$24,000 in 2000), demanding tastes and years of exposure to Western products, Hong Kong consumers are a leading indicator of potential consumer demand in China. Hong Kong should be viewed as

an incubator or microcosm for long-term export projects in China—an easy-entry, exporter-friendly laboratory for the world's most populous country. These same factors will also sustain Hong Kong as a significant market in its own right.

In the short term (one to five years), Hong Kong traders will likely continue in their present role, with some modifications. Hong Kong traders are well positioned to benefit from increasing opportunities to provide such services as marketing, accounting, documentation, shipping, insurance and financing.

The more the Chinese market opens, the more challenging and competitive it will become. And although trade patterns will likely change markedly, the pace of change will be much slower than most people expect—at least 10 years. ■

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The Effect of Trade Liberalization On China's Retail Sector

By Peter Moustakerski

China's retail food sector has experienced remarkable growth in the past 10 years, and at the same time undergone profound structural transformation. Although this retail revolution has been more rapid and evident in larger cities like Shanghai, Guangzhou, Dalian and Beijing, the trend is unmistakably present for the whole of China.

The Retail Universe

Food plays a central role in Chinese culture and in personal and business relationships. So it's not surprising that consumer foods have been a driving force behind China's retail revolution. Chinese consumers tend to be savers rather than spenders, so the market remains driven by price—an area where imports usually have a difficult time competing with local counterparts.

The average Chinese city offers consumers a broad spectrum of retail outlets in which to buy food products—not just food-driven outlets, but also traditional department stores, which normally dedicate at least one floor to food items. Most Chinese importers of high-value food and beverage products are either smaller, well-connected state-owned trading companies, or privately owned and/or operated businesses.

Neither type traditionally has import rights or access to foreign exchange, which remain prerogatives of large state-owned import/export corporations. A general distributor employs the services of an import/export corporation, paying for the use of

its import license—normally 1–2 percent of the transaction value.

Supermarkets and convenience stores, modeled after popular commercial formats in Western and Southeast Asian countries, have brought more choice and more comfortable shopping environments to Chinese consumers. Another foreign concept, the chain store, has helped to consolidate the sector and reinforce the use of brands.

Supermarkets remain the most widespread retail format. Foreign operators have had little success in this format, as a result of fierce competition from domestic counterparts with access to supermarket technology and management know-how.

Convenience stores are a relatively new phenomenon in China. With their relatively low-cost setup, local neighborhood presence and long hours (often round-the-clock), outlet numbers have expanded dramatically.

Revolution and Rivalry

Turbulent growth and fierce rivalry

typify China's emergent retail sector. Trends are sharp and cyclical, starting with the birth of a great opportunity, progressing through cut-throat competition and ending in over-saturation.

For example, the department store boomed in the late 1980s and early 1990s, when everyone with access to financing rushed to build one. But by the late 1990s, department stores had been driven into a corner by modern Western-style supermarket chains.

The hypermarket format, pioneered by such retail giants as Metro of Germany, Makro of Holland, Carrefour of France and Wal-Mart of the United States, is driving the latest phase of the retail revolution. Chinese consumers can get their fresh, frozen and dry groceries, as well as clothes, household goods and electronics, in the same clean, comfortable, professionally managed superstore.

The food area is the core (and the main attraction) of the hypermarket. In addition to extensive arrays of dry and frozen foods,



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a hypermarket's food area boasts a sizable fresh section, featuring fruits, vegetables, meats and seafood, as well as delis, bakeries, butcher shops and chicken rotisseries.

Leading hypermarket chains owe their success in part to the fact that they have managed to bypass China's inefficient, low-tech (and therefore costly) wholesale system, and are ordering directly from suppliers and manufacturers, charging them exorbitant slotting fees.

Hypermarkets keep prices low by holding down procurement and warehousing costs. Foreign hypermarkets pioneered the concept of regional purchasing centers, bypassing the multi-layered, fragmented and cumbersome purchasing network of wholesalers and distributors that serviced old-fashioned department stores and even supermarkets.

Thanks largely to their low prices, hypermarkets and discount warehouse stores are forcing traditional supermarket chains and convenience stores to restructure, consolidate and cut prices to try to stay competitive.

Penetrating Challenges

Hypermarkets may seem to offer manufacturers and suppliers the promise of consistently large sales volumes and nationwide distribution reach. But in reality, no hypermarket chain has yet achieved national penetration or distribution. And they pose other challenges too, particularly for small- and medium-sized enterprises.

Suppliers must negotiate with, and deliver to, each hypermarket outlet individually. Each store has a large degree of autonomy on procurement and must maintain its own profitability.

Hypermarkets generally buy from manufacturers or large distributors. Imports, which account for 5 percent or less of their

stocks, are sourced through established import agents or general distributors. Moreover, hypermarket managers are anything but accessible—particularly to a small- or medium-sized supplier.

In addition to high slotting fees, retailers charge for in-store promotion activities. Most retailers also impose burdensome credit terms on suppliers, commonly demanding payment in 90-180 days. Leading hypermarkets require that products meet certain sales criteria—if they don't, they disappear from shelves in as little as a month. To re-list a product, suppliers must pay the listing fee again.

Constraints and Caveats

Importing and selling foreign-made food products is growing increasingly complicated. China's legal system and infrastructure are underdeveloped, and enforcement is erratic and often biased. Corruption and local protectionism are likely to remain serious problems for some time. High duties

are levied on imports, rendering them considerably more expensive than their local counterparts by the time they land on retail shelves.

New laws and standards have been introduced to prepare China for membership in the World Trade Organization (WTO). While in the long run they will bring transparency and a legal framework to the trade environment, in the short term they are causing confusion among importers and exporters alike. Regulations tend to be either new or ambiguously worded, so enforcement tends to be arbitrary and opaque.

Another challenge that food products face is the myriad of licenses required to sell in the retail market. Any food product must have a hygiene certificate from the government of the locality where it is on sale. Functional or health foods must have health-food certificates.

Labeling requirements can be cumbersome. Food products must meet the latest regulations, which usually means developing new labels and packaging in Chinese. Products containing ingredients derived through biotechnology must have biotech safety certificates and be properly labeled.

China's Accession

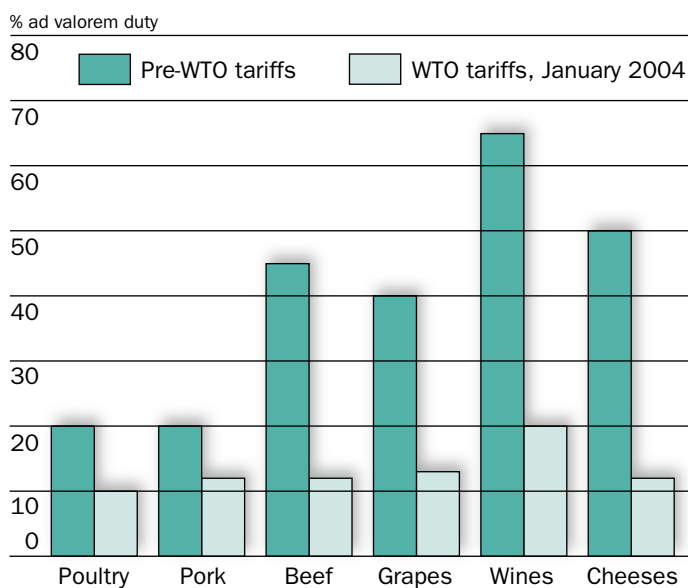
The U.S.-China Bilateral WTO Market Access Agreement of 1999 will significantly reduce China's import barriers on U.S. agricultural products. On average, the overall duty will fall from 22 to 17.5 percent. The accompanying charts show the tariff reductions in greater detail.

Experienced China watchers are quick to point out that Beijing's WTO concessions are the latest milestone in a longstanding path toward deregulation and import liberalization going back to the late 1970s, when China made its first moves to

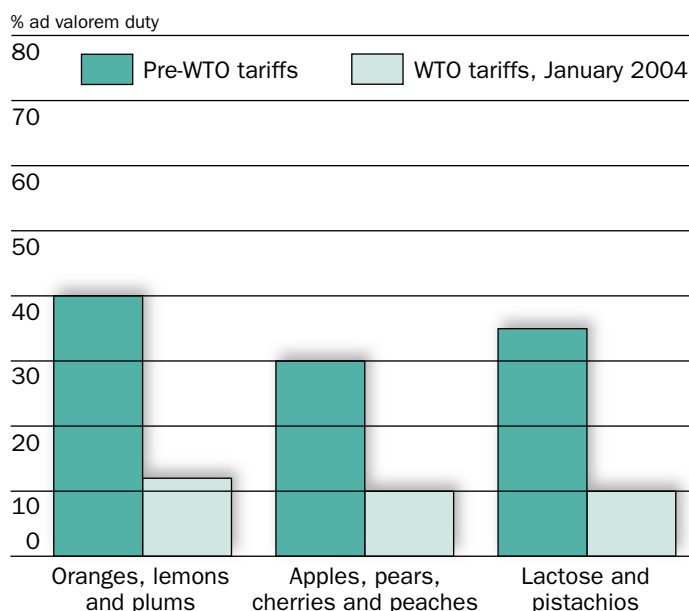


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China's Tariff Reductions on Agricultural Products of Priority Interest to the United States Will Be Substantial



Tariff Reductions on Other Important Products Will Also Be Significant



reduce barriers to economic growth and make its economy more market-oriented.

While confident that China will continue to liberalize its import market in the coming years, these astute observers are also quick to temper expectations for WTO market openings by pointing out the various bumps in the road toward liberalization over the past 20 years, and the political imperative of cushioning China's rural economy against a flood of competing imports.

While Beijing's WTO concessions are significant, they are not sufficient by themselves to guarantee huge gains in trade. For instance, the agreement provides for import tariffs to fall, but continued restrictions on the availability of foreign exchange (Chinese currency is still not fully convertible) may make it difficult for Chinese importers to pay their foreign suppliers.

The Market's Promise

The penetration of imported foods into the Chinese retail market is still fairly shallow. Although products with well-known brand names are widespread, they are usually produced locally. Imports account for less than 5 percent of stocks in the average supermarket or hypermarket, and are even less common in other retail formats.

But many leading chains are realizing that featuring more and better quality imports is a good way to attract customers.

Several chains are either exploring the opportunity or already establishing sourcing operations in the United States and other Western countries to increase their portfolios of imports, particularly dry groceries (such as confectionery items, snacks, bagged and boxed items, canned goods and baby foods), frozen products and ready-to-eat foods.

It is not customary for importers to maintain inventories of imported food products at their own expense. The exporter or supplier must usually shoulder the costs of inventories; secondary distributors and retailers keep small stocks, and reorder only if sales are satisfactory.

A few logistics services companies, some with foreign participation and management, have established themselves in port areas and free-trade zones. They offer a one-stop-shop solution for companies interested in importing and exporting, by arranging customs



clearance, shipment handling and storage, bonded warehousing and foreign exchange clearance. They handle product shipments and maintain transparent international-standard accounts. U.S. exporters should consider using logistics providers when planning long-term market strategy.

Recommendations for a Sensible Approach

Everything is different in China—tastes, customs, culture, infrastructure, business rules. Even the most successful, experienced business would be wise to devote ample time and resources to identify and study a target market. Finding the right Chinese partner, establishing a reliable import channel, maintaining an efficient sales and distribution network and breaking into the leading volume-generating retail chains are among the crucial challenges that exporters face. Competition from domestic or joint-venture counterparts is the most serious challenge facing U.S. suppliers and exporters in the Chinese market.

To be successful, exporters must:

- **Find a local Chinese partner and/or distributor:**

This step is crucial. An exporter's success in China hinges on the right local partner, representative or distributor. An exporter with a long-term vision for China should thoroughly investigate the market and establish viable relationships with reputable and effective representatives.

The most important task for an exporter is to identify and sign up with a company specifically designated as an "importer" or "general distributor." The importer must be able to handle all the import formalities (i.e., act as a customs and logistics broker) and have a network of established retail customers.

The U.S.-China-Hong Kong Nexus

The channels that traditionally supplied imported foods to the market (most notably gray channels via Hong Kong) are generally opaque, unreliable and shrinking due to increased scrutiny by the central government in Beijing. In the past, some Hong Kong companies have been able to deliver foods into China at competitive prices by avoiding import duties and fees through smuggling, or by reducing duties and fees through under-invoicing (declaring lower quantity or unit price than that in the actual shipment).

Since 1998, when Beijing began cracking down on illegal gray channel activity, many exporters have invested effort and capital into building legitimate import channels directly through mainland ports, such as Shanghai, Dalian, Qingdao and Tianjin. As a long-term strategy, exporters should move away from gray channels, which are likely to prove increasingly risky and unreliable, and explore legitimate channels with reputable importers in China.

Above all, the importer must be able to pay for the imported products by remitting hard currency to the exporter. Exporters should choose representatives slowly and carefully. Hastily made partnerships are perhaps the most common cause of failure in China.

- **Focus on a market audience, segment or niche:**

Faced with the enormity of the Chinese market, some exporters attempt to diversify too much, too early, trying to cater to the entire market spectrum. Often this is a recipe for disaster.

- **Go slow in the beginning, concentrating on gradual but sustainable growth:**

Consequences for stretching resources across vast, disparate areas—ignoring the preferences and requirements of each local market—can be severe. Any sudden weakening of demand or appearance of competition usually proves fatal.

- **Adapt your product to the individual market—labels, flavors, package size and price:**

Exporters are better off devoting resources to each local market and basing expansion solely on tangible successes and real demand. Testing every attribute of a product (flavor, packaging, pricing, shelf life) with consumer focus groups is highly recommended. All marketing is local.

- **Invest wisely in market promotion through trade shows and in-store promotions:**

Attending only quality trade shows is a good way to start. Once in the market, in-store promotions have proven to be a cost-effective way to establish sales. ■

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Trade Notes...

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U.S. Fishery Exports Projected To Grow This Year

Fiscal 2002 exports of U.S. fishery products are expected to continue on an upward trend. Sales to Japan and Canada, our two largest markets, are projected to grow slightly. Exports to Japan may benefit from concerns over bovine spongiform encephalopathy, as those to the European Union (EU) have. Exports to South Korea and the EU have been growing steadily for the past two years, and are expected to continue to increase again in fiscal 2002 as growing demand in these markets exceeds domestic seafood supply.

FAS Weekly Export Sales Report Adds Beef

FAS began reporting on U.S. export sales of fresh, chilled and frozen muscle cuts of beef in its weekly U.S. Export Sales report on Dec. 13, 2001. The U.S. Export Sales report also includes certain grains, soybeans and soybean products, wheat and wheat products, rice, flaxseed, linseed oil, cotton and cottonseed products, and cattle hides and skins. The weekly aggregated beef data will provide livestock producers, ranchers and others with up-to-date information to analyze foreign market conditions and consumer demand. Producers will be able to use the data to make economic forecast decisions on the flow of beef into both domestic and export markets. Export sales reporting is mandated by Section 602 of the Agricultural Trade Act of 1978.

U.S. Horticultural and Tropical Product Exports Set Record

U.S. exports of horticultural products reached a record \$11.1 billion in fiscal 2001, up 5 percent from 2000. U.S. exports of sugar and tropical products hit a record \$2.6 billion in fiscal 2001, up 14 percent from 2000. Some of the fastest-growing product sales in fiscal 2001 were almonds, up 48 percent; pistachios, up 39 percent; apples, up 24 percent; grapes, up 20 percent; carrots, also up 20 percent; and prunes, up 14 percent.



Also in This Issue:

- Assessments and advice about France's bullish pet food market
- Wrap-up of U.S. agricultural exports in fiscal 2001

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